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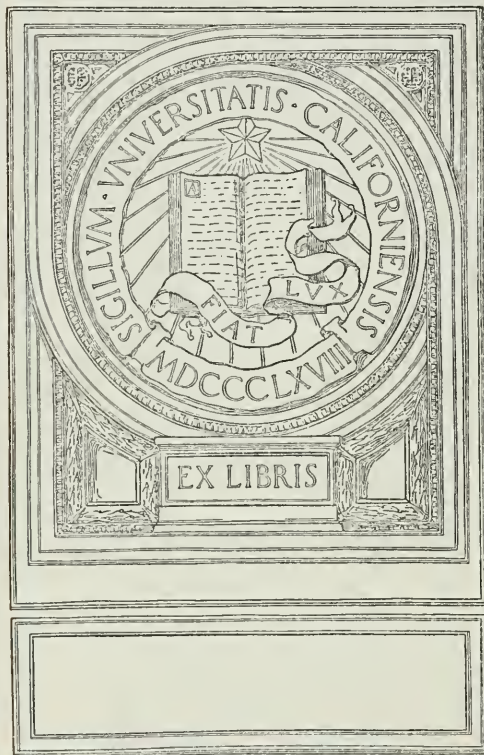
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The Assessment of Income Tax
by
William Schooling

UNIVERSITY OF CALIFORNIA
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XVII. 19. 2

THE ASSESSMENT OF INCOME TAX

BY
WILLIAM SCHOOLING

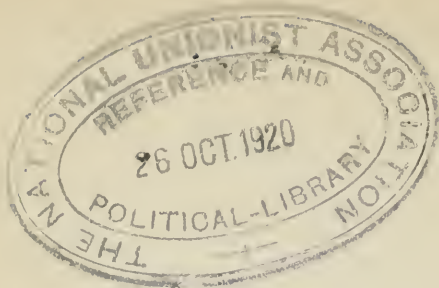
AUTHOR OF "INWOODS TABLES," "LIFE ASSURANCE EXPLAINED," ETC.

Reprinted from THE DAILY TELEGRAPH

LONDON

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1910



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THE ASSESSMENT OF INCOME TAX

THE Income-tax Regulations in the Finance Bill of 1909 are of an exceedingly complicated character. They involve four different rates of tax, five different amounts of abatement, eleven sudden jumps in the rate of tax payable, and the method adopted is such as to call for a rearrangement of the whole system in the event of the income-tax being raised or lowered in the future.

In this article I am in no way concerned with the justice or wisdom of the provisions of this or of subsequent Budgets. My object is simply to propose a method of assessing income which

1. Requires only one rate of income-tax.
2. Avoids the sudden jumps that occur at present.
3. Allows for future variation in the rate of tax without any change in the method of assessment.

The general method which I suggest for accomplishing these objects is to make abatements of specified amounts, and add to, or subtract from, the income, less the abatement, certain simple proportions. Apart from the particular applications of the method, which I give below, and which approximately conform to the provisions of the 1909 Budget,

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the point that I desire to make is that this "abatement and proportion" system can be adjusted to any requirements which, if they were recognised as fair and appropriate, could become permanent, and the rate of income-tax could be varied without in any way disturbing the relative burdens upon incomes of different amounts.

The adoption of the method I propose, which is quite a different matter from the adoption of the details which I give, would bring us back to the sweet simplicity of former times, when the yield from each penny in the pound of income-tax was a known quantity, subject only to such fluctuation as might result from evasion of tax when the rate was excessive.

INCOMES UP TO £1,000.

It is convenient to consider the application of this method in three stages, dealing first with incomes not exceeding £1,000. In regard to these, the provisions of the 1909 Budget (A) and the plan I propose (B) are as follows :

| | Income. | Abatement. | Earned. | | Unearned. | |
|---|---------------|------------|-----------|--------------|-----------|--------------|
| | | | Subtract. | Tax in £. | Add. | Tax in £. |
| A | £0— 400 . . | 160 | 0 | 9 <i>d.</i> | 0 | 14 <i>d.</i> |
| | 400— 500 . . | 150 | 0 | 9 <i>d.</i> | 0 | 14 <i>d.</i> |
| | 500— 600 . . | 120 | 0 | 9 <i>d.</i> | 0 | 14 <i>d.</i> |
| | 600— 700 . . | 70 | 0 | 9 <i>d.</i> | 0 | 14 <i>d.</i> |
| | 700—1,000 . . | 0 | 0 | 9 <i>d.</i> | 0 | 14 <i>d.</i> |
| B | 0—1,000 . . | 200 | One 6th | 14 <i>d.</i> | One 4th | 14 <i>d.</i> |

For the ten plans of the Budget I would substitute two. In place of four different abatements, and two rates of tax, I would have one abatement, one tax, and two proportions.

How this method works out in the case of unearned incomes may be seen from the following examples :

| | | | | | |
|-----------------------------|-------|-------|-------|-------|--------|
| Actual income | £360 | £420 | £560 | £640 | £1,000 |
| Abatement | 200 | 200 | 200 | 200 | 200 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Result | £160 | £220 | £360 | £440 | £800 |
| Add one-fourth | 40 | 55 | 90 | 110 | 200 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Income for assessment | £200 | £275 | £450 | £550 | £1,000 |
| Under 1909 Budget | 200 | 270 | 440 | 570 | 1,000 |

In regard to earned incomes, I proceed on the assumption that the rate of tax is two-thirds of the rate charged upon unearned income. I therefore reduce the earned income to two-thirds of the corresponding unearned, and charge one rate of tax for both.

Two-thirds of 1s. 2d. is 9 1-3d., as compared with the actual tax of 9d. imposed by the Budget of 1909. It is not improbable that future rates might be 12d. and 8d., or 15d. and 10d. It is this assumption of the "earned" rate being two-thirds of the "unearned" rate of tax that produces the rule of deducting one-sixth from earned incomes in place of adding one-fourth, as is done on unearned incomes. Take an example, and assume the rates of tax to be 8d. and 1s. respectively :

| | | |
|------------------------------|-------|-------|
| Actual Income | £584 | £584 |
| Subtract | 200 | 200 |
| | <hr/> | <hr/> |
| Result | £384 | £384 |
| Add one-fourth | 96 | — |
| Subtract one-sixth | — | 64 |
| | <hr/> | <hr/> |
| Assessable income | £480 | £320 |
| Rate of Tax | 8d. | 12d. |
| Amount of Tax | £16 | £16 |

It is seen to give exactly the same result to charge the higher tax on the smaller income as to charge the

lower tax on the larger income. This method gives the advantage that an increase or decrease in the rate of tax leaves the relative burdens of different classes of incomes absolutely unaltered. To change the rate from 9d. to 10d. is to increase the amount payable by one-ninth; to change it from 14d. to 15d. is to increase the amount payable by the smaller proportion of one-fourteenth; hence it seems a better plan to have a permanent method of assessment, settling once for all the relative burdens of different incomes, and causing all incomes to be affected in equal proportion when the rate of tax is changed.

Since the great majority of incomes are under £1,000, it appears especially desirable to have two rules for dealing with these incomes instead of ten.

There are other benefits as well. One of these is the avoidance of sudden jumps in the amount of tax payable on incomes that differ but little from one another. Although under the Budget £500 pays on one scale and £501 on a higher scale, it is convenient to show the jumps on the same incomes when calculated on the two scales. These are seen below :

| Actual Income | £400 | £500 | £600 | £700 |
|---------------------|---------|---------|----------|---------|
| EARNED— | | | | |
| Tax on higher scale | £9 7 6 | £14 5 0 | £19 17 6 | £26 5 0 |
| „ lower „ | 9 0 0 | 13 2 6 | 18 0 0 | 23 12 6 |
| Amount of jump | £0 7 6 | £1 2 6 | £1 17 6 | £2 12 6 |
| UNEARNED— | | | | |
| Tax on higher scale | 14 11 8 | 22 3 4 | 30 18 4 | 40 16 8 |
| „ lower „ | 14 0 0 | 20 8 4 | 28 0 0 | 36 15 0 |
| Amount of jump | £0 11 8 | £1 15 0 | £2 18 4 | £4 1 8 |

Any man is likely to persuade himself that his income is £700 subject to an effective tax of 12½d.,

rather than £701 subject to 14d. The Budget plan is obviously foolish, irregular, and unfair. Under the plan I suggest the amount of tax payable on incomes at the changing points is identical by the lower and the higher scales. There are no jumps at all.

On the diagrams the thick continuous lines represent the amount of income-tax payable under the 1909 Budget; the dotted lines show the working of the method I suggest. In each case the upper lines refer to unearned income, and the lower lines to earned income. (See plate at end.)

The figures at the bottom of the diagram show the amount of income; the figures at the side indicate the amount of tax. The sloping lines show the effective rate of tax. Thus an earned income of £800 is seen to pay, under the Budget regulations, a total of £30, and to be at the effective rate of 9d. in the pound.

The diagrams exhibit the jumps or irregularities in the Budget arrangements, and the absence of these jumps in the dotted lines which represent the method I propose. These dotted lines are straight from point to point. In the main, for incomes under £1,000, the suggested plan merely smooths out the irregularities of the Budget. There are three points to notice in connection with it.

The first is that incomes under £200 are exempt, instead of under £160 as at present. There seems much to be said for such exemption, but if it were not considered desirable, it is quite simple, by the "abatement and proportion" method, to charge tax on all incomes exceeding £160. If this were to be done the rule for unearned incomes would be, as in the Budget, an abatement of £160 and tax at 1s. 2d. for incomes up to £360, and for incomes from £360

to £1,000 the rule I gave above. A change at this point involves no jump. An abatement of £160 from £360 gives an assessable income of £200; an abatement of £200 and an addition of one-fourth of the balance also gives an assessable income of £200. For earned incomes up to £360 there would be, as at present, an abatement of £160, and a subtraction of one-third from the balance, in order to charge the higher rate of tax on the smaller income; in this case also there is no jump.

The second point to notice is that unearned incomes from £700 to £1,000, and earned incomes from £700 to £875, pay less than under the 1909 Budget. Considering that a man with £700 is not so well off now as a man with the same income was formerly, this slight relief seems by no means inappropriate; but if it is not thought advisable the existing conditions can be adhered to more closely by a modification of the abatement and proportion suggested.

The third point which calls for comment is that my suggestions for earned incomes up to £1,000 are, on the whole, slightly less favourable to income-tax payers than the conditions of the Budget. This is due to the assumption that the tax on earned incomes should be two-thirds of the rate on unearned incomes; consequently, as I am working on the basis of the current Budget, I am dealing with a tax of 9 1-3d., instead of 9d. This accounts for the amount of tax payable on incomes from £875 to £1,800 being more than the amount charged under the Budget. For incomes within these limits my suggestion is based on a tax of 9 1-3d., while the Budget rate is 9d. This discrepancy might disappear or be reversed with a change in the rate of tax.

It remains to show the effective tax payable under the Budget and in accordance with my suggestions.

| Effective Tax in £. | Earned Income. | | Unearned Income. | |
|------------------------|----------------|-----------|------------------|-----------|
| | Budget. | Proposed. | Budget. | Proposed. |
| 1 <i>d.</i> | £180 | £219 | £172 | £212 |
| 2 <i>d.</i> | 206 | 241 | 187 | 226 |
| 3 <i>d.</i> | 240 | 269 | 204 | 241 |
| 4 <i>d.</i> | 288 | 304 | 224 | 259 |
| 5 <i>d.</i> | 360 | 350 | 249 | 280 |
| 6 <i>d.</i> | 450 | 412 | 280 | 304 |
| 7 <i>d.</i> | 540 | 500 | 320 | 333 |
| 8 <i>d.</i> | None | 636 | 373 | 368 |
| 9 <i>d.</i> | 700-1,000 | 875 | 420 | 412 |
| 10 <i>d.</i> | — | — | None | 467 |
| 11 <i>d.</i> | — | — | 560 | 538 |
| 12 <i>d.</i> | — | — | None | 636 |
| 13 <i>d.</i> | — | — | None | 778 |
| 14 <i>d.</i> | — | — | 700-1,000 | 1,000 |

This table, of course, means that an earned income of £240 pays, according to the Budget of 1909, exactly 3*d.* in the pound, which, since there are 240 pence in the £1, is £3 in all. The abatement on an income of £240 is £160, leaving an assessable income of £80, which, when tax is charged at the rate of 9*d.*, gives £3 as the amount payable. It is a consequence of the jumps in the Budget that there is no earned income which pays exactly 8*d.*, and no unearned income which pays exactly 10*d.*, 12*d.*, or 13*d.*

Perhaps it will not be any consolation to income-tax payers to know that under the "abatement and proportion" method the incomes which pay tax at the effective rates of 1*d.*, 2*d.*, 3*d.*, &c., in the pound are in harmonical progression; in other words, the relations between them have the same sort of character as the numbers of the vibrations in the notes of the musical scale. If unity were divided by each of these numbers in succession, the differences between the

successive quotients would be a constant quantity. It may, however, be unseemly to refer to income-tax and harmony in the same sentence.

Such points as the rebate of income-tax on premiums paid for life assurance, and the methods of dealing with incomes that are partly earned and partly unearned lend themselves to simpler treatment by the method of abatement and proportion than by the rules of the Budget.

INCOMES FROM £1,000 TO £3,000.

For unearned incomes from £1,000 to £3,000 the 1909 Budget makes no abatement, and charges tax at 1s. 2d. in the pound. I do not suggest any change in this plan. On the diagram it is a straight line from the £1,000 to the £3,000 point; this is, perhaps, the one really rational feature of the present income-tax regulations.

On earned incomes from £1,000 to £2,000 the Budget charges 9d. in the pound; on earned incomes from £2,000 to £3,000 the tax is 1s. in the pound; and on earned incomes above £3,000 the tax is 14d. This involves two big jumps; there is a sudden increase of 3d. in the pound when the income exceeds £2,000: on the lower scale the amount payable is £75, on the higher scale it is £100; the jump is £25. The jump at £3,000 is also £25, since it is 2d. in the pound on £3,000. This, as the partially discredited Euclid would have said, is absurd. I am by no means sure that this is not immoral, or at least conducive to the frigid and calculated lie. If a man's income is £2,001 he is greatly tempted to return it as £2,000, and save about £25 by doing so.

There are various ways of meeting these points, and the suggestions that I make are that for earned incomes from £1,000 to £1,800 there should be no abatement, but that one-third should be subtracted and the uniform high rate of income-tax be charged. If the income is £1,800 and we subtract one-third, the assessable income is £1,200. A tax of 1s. in the pound on £1,200 is equivalent to 8d. in the pound on £1,800; similarly a tax of 1s. 2d. on £1,200 equals a tax of 9 1-3d. on £1,800. It is because I have supposed that the tax on earned incomes should be two-thirds of that on unearned that the tax comes to 9 1-3d., and the dotted line on the diagram, which shows the working of my proposals, is higher than the continuous line which shows the Budget tax of 9d.

For incomes from £1,800 to £3,000 I suggest an abatement of £1,000 and an increase of the balance by one-half. It is necessary to have a large abatement and a large proportion in order to fit in approximately with the present Budget, which charges 9d. in the pound on incomes of £2,000, and 1s. 2d. on incomes that exceed £3,000. We have to avoid two big and sudden jumps.

It will be seen that an income of £1,800 pays exactly the same amount of tax whether there is no abatement and a deduction of one-third, or an abatement of £1,000 and an addition of one-half; the assessable income is £1,200 in both cases.

It is the same with earned incomes of £3,000, which, in order to conform with Budget regulations, I have made to coincide with unearned incomes. In the case of the latter the tax is assessable on the actual income of £3,000; in the case of earned incomes the deduction of £1,000 from £3,000 and the subsequent

addition of one-half, brings us to an assessable income of £3,000, which is identical with the arrangements for unearned incomes.

The diagram makes it clear that my suggestions involve a higher rate than the Budget for incomes from £1,800 to £2,000; a lower rate for incomes from £2,000 to £2,333; and a higher rate from that point up to £3,000.

It should be remembered that I am arguing for a method which seems to me to have many advantages, and not for a Budget, with the merits of which I am not concerned. I am simply trying to show that rational methods can be substituted for irrational without deviating greatly from the results proposed in the Budget.

The effective tax charged under the Budget is 9d. in the pound from £1,000 to £2,000; 1s. on incomes from £2,000 to £3,000; and 1s. 2d. on incomes exceeding £3,000. There is no earned income which pays an effective tax of 10d., 11d. or 13d. Under the proposed plan the effective tax is 10d. on incomes of £1,909; it is 11d. on £2,100; the tax is 1s. in the pound on incomes of £2,333; it is 1s. 1d. on £2,625, and 1s. 2d. on £3,000. This again is a harmonical progression.

INCOMES ABOVE £3,000.

For incomes above £3,000 no distinction is made in the Budget between earned and unearned incomes, and therefore I suggest no distinction between the two. The Budget provides that from £3,000 to £5,000 the tax is 1s. 2d. in the pound on the actual income; above £5,000 there is a super-tax of 6d. in the pound on the amount by which the income exceeds

£3,000. In other words, the tax on incomes above £5,000 is 1s. 8d. in the pound, subject to an abatement of income of £900. A tax of 6d. in the pound on £3,000 is 18,000 pence, and 18,000 pence is equivalent to a tax of twenty pence in the pound on an income of £900. It would have been more in accordance with the arrangements adopted for smaller incomes had the Budget provided that the tax on incomes exceeding £5,000 should be 1s. 8d. in the pound, subject to an abatement of £900 from actual income.

The super-tax regulations of the Budget can be stated in terms of abatement and proportion, with one rate of tax. We have just seen that the exclusion of the first £3,000 from super-tax is equivalent to an abatement of £900 from income. The super-tax is an increase from fourteen pence to twenty pence, which is an addition of six-fourteenths to the normal tax. It is immaterial whether the income or the income-tax is increased by this six-fourteenths so far as the result is concerned. Take, for example, an income of £10,000. A tax of 14d. on £3,000, plus 20d. on £7,000, gives the amount payable as £758 6s. 8d. Identical results would be obtained by making an abatement of £900 and adding six-fourteenths, which gives an assessable income of £13,000 at 14d. in the pound. The abatement that would exactly suit the Budget regulations, however, is the awkward fraction of six-fourteenths or three-sevenths, and the Budget increase in tax starts with a sudden jump at incomes exceeding £5,000. An additional £1 of actual income calls for an additional £50 of income-tax. This jump is clearly shown in the smaller diagram. (See plate at end.)

Surely conditions of this sort are better avoided, and they can be eliminated by the abatement and proportion method in a variety of ways. The plan shown in the diagram is to make an abatement of £1,400 from £4,200 upwards, and then increase the balance by one-half, and charge the one rate of fourteen pence in the pound throughout. This plan gives a result identical with that of the Budget at £4,200, and involves no jump. The subtraction of £1,400 from £4,200 leaves £2,800, the addition to which of one-half brings us back to the £4,200. This plan involves the payment of a slightly increased amount as compared with the Budget, for incomes from £4,200 to £5,000; thereafter the amount payable is less than under the Budget until we come to £11,400, after which point the suggested plan yields more than the Budget. The difference between the Budget and this proposal is very slight at all points.

THE CONCLUSION OF THE WHOLE MATTER.

Without repeating the conditions of the Budget, which are well known and have already been described in this article, it may be well to summarise the particular methods which I suggest for dealing with all incomes, from the lowest to the highest. They are as follows :

| | Income. | Abatement. | Proportion. | Tax in £. |
|--------------|-----------|------------|---------------|-----------|
| Unearned . . | £0-1000 | £200 | plus One 4th | 14d. |
| Unearned . . | 1000-4200 | 0 | 0 | 14d. |
| Both . . . | 4200-up | 1400 | plus One half | 14d. |
| Unearned . . | 0-1000 | 200 | less One 6th | 14d. |
| Unearned . . | 1000-1800 | 0 | less One 3rd | 14d. |
| Unearned . . | 1800-3000 | 1000 | plus One half | 14d. |
| Unearned . . | 3000-4200 | 0 | 0 | 14d. |

The amounts of the abatements and proportions suggested can be varied to an unlimited extent and arranged to suit any conditions that are considered desirable. The above results approximate to the conditions of the somewhat elaborate arrangements of the Budget for 1909, and it may be said that a method that will fit that will fit anything.

The important thing, however, is the advantages presented by the abatement and proportion method of assessment of income.

1. There is one rate of tax for all incomes.
2. The tax can be changed without altering the relative burden upon different classes of income.
3. The yield from each penny in the pound of income-tax again becomes a known amount.
4. There are no sudden jumps such as occur under the Budget.
5. The absence of jumps tends to the accuracy of income-tax returns.
6. There are two methods for dealing with incomes under £1,000, in place of ten methods under the Budget; and for the whole range of incomes six plans instead of twelve plans.
7. The method of assessment could be permanent, whatever changes were made in the rate of tax.
8. The method is rational, instead of empirical.
9. It probably facilitates estimates of revenue.

I hope I may claim to have established the superiority of the method I advocate. Perhaps the last two advantages mentioned will tell against its adoption by Chancellors of the Exchequer.

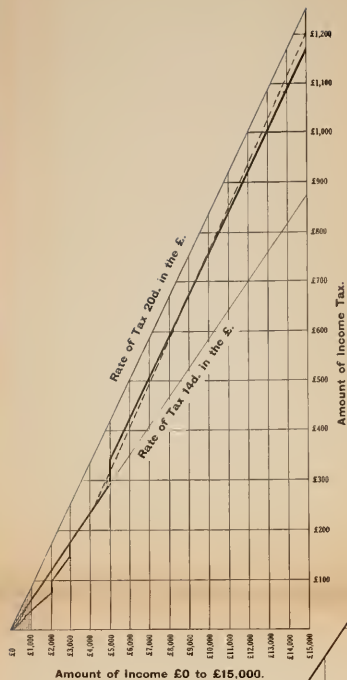
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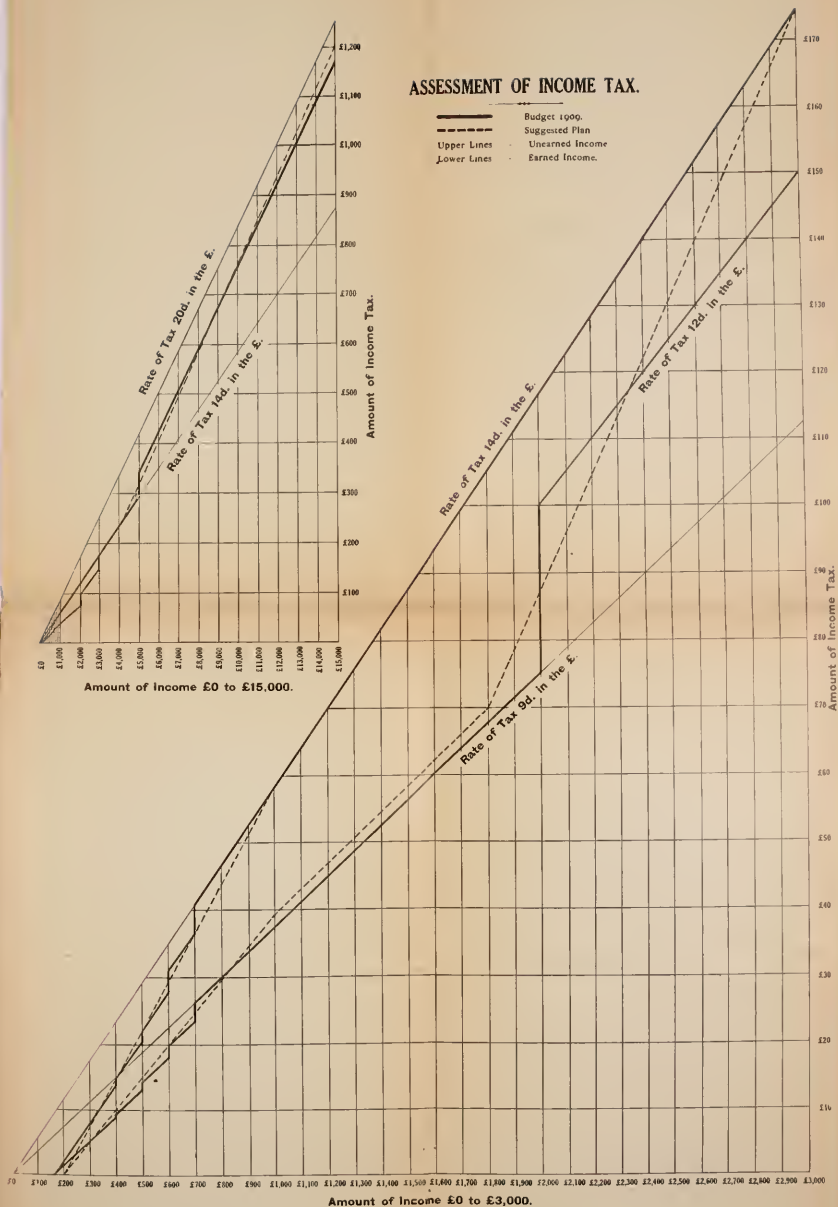
ASSESSMENT OF INCOME TAX.

— Budget 1909.
 - - - Suggested Plan
 Upper Lines · Unearned Income
 Lower Lines · Earned Income.



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